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IN THE

Supreme Court of the United States

October Term, 1992

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION
Petitioner,

v.

OHIO POWER COMPANY, *et al.*
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, AS *AMICUS CURIAE* IN SUPPORT OF BOTH PETITIONERS

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS *AMICUS CURIAE* IN SUPPORT OF BOTH PETITIONERS

INTEREST OF *AMICUS CURIAE*

The National Association of Regulatory Utility Commissioners (NARUC) is a quasi-governmental nonprofit

organization founded in 1889. The NARUC represents the collective interest of the State regulatory commissions charged with regulating the rates and conditions of service of electric, natural gas and telephone utilities operating within their respective jurisdictions. The NARUC's member commissions are obligated under State law to ensure that the rates charged to retail consumers are just and reasonable. The NARUC's mission is to serve the public interest by seeking to improve the quality and effectiveness of public utility regulation in America.

The NARUC submits this brief as *amicus curiae* in support of the petitions for certiorari filed by Arcadia, Ohio, *et al.* and the Federal Energy Regulatory Commission (FERC) because review by this Court is essential to prevent the harm the decision below will have upon the ability of State regulatory commissions to effectively scrutinize and regulate the retail rates of electric utilities. That decision eliminates the FERC's jurisdiction to determine the justness and reasonableness of fuel charges an electric utility can include in its *wholesale* rates where the utility purchases its fuel through affiliate contracts subject to the jurisdiction of the Securities and Exchange Commission (SEC). Left unreviewed, the decision also could be used to prevent State public utility commissions from reviewing similar costs and determining the

extent to which they are properly passed through to the *retail* consumer. The resulting gap in *both* federal and State rate regulation would allow any utility owned by a registered public utility holding company to buy fuel or other goods and services from an affiliate at inflated prices and pass through its entire cost to ratepayers without any scrutiny by a ratemaking agency at either the Federal or State level.[1]

SUMMARY OF ARGUMENT[2]

Left unreviewed, the decision of the court below will have a devastating effect not only on the FERC's regulation of wholesale power sales, but also could provide a springboard for substantial preemption of State regulation of the retail rates of electric utility subsidiaries of registered holding companies. The NARUC respectfully submits that this court must grant the respective petitions for the reasons therein stated, but also to protect the integrity of State utility regulation. Unless reviewed and reversed, the lower court's

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[1] Pursuant to Rule 36 of the Rules of this Court, NARUC has obtained the consent of the parties to the filing of this brief. Copies of the letters of consent have been filed with the Clerk of the Court.

[2] The facts of this case are set forth fully in the two petitions. Accordingly, the NARUC will assume familiarity with those facts and focus on the reasons for granting the petitions.

erroneous reliance on this court's decisions finding preemption of State retail regulation of holding company affiliates carries the clear threat of federal preemption under a new guise -- the SEC's purported regulation of interaffiliate transfer prices "at cost." Because Congress did not intend such preemption of either FERC or State regulatory authority, the petitions must be granted.

ARGUMENT

THE PETITIONS MUST BE GRANTED TO PREVENT HARM TO STATE REGULATION OF ELECTRIC UTILITY RATES AND SERVICES

In *Arcadia* v. *Ohio Power Co.*, _ U.S. _, 111 S. Ct. 415 (1990) (*Arcadia I*), this Court reversed the same court of appeals' prior attempt to construe section 318 of the Federal Power Act (FPA), 16 U.S.C. § 825q, to divest the FERC of its authority to disallow the pass-through of costs from "SEC-approved" affiliated coal companies in establishing just and reasonable wholesale power rates. In its decision below, the court of appeals has reinstated its prior holding, this time invoking Section 13(b) of the Public Utility Holding Company Act (PUHCA), 15 U.S.C. § 79m(b). Section 13(b) provides for SEC jurisdiction over certain transactions among holding company affiliates, and prohibits sales of goods between affiliates unless they are "at cost." The court below held that the "at cost" standard set forth in Section 13(b) governs not

only the transfer price of goods and services among holding company affiliates, but also dictates the extent to which those costs can be passed through and recovered in rates, irrespective of whether the costs are reasonable or consistent with market prices. This holding creates a substantial risk that the authority of State public utility commissions to review those costs, which are central to retail rates, would likely be preempted under Supremacy Clause principles. Stated simply, the decision below could be read to preclude State public utility commissions from satisfying their respective statutory mandates to ensure that retail utility rates are just and reasonable.

This Court has stated that "this Court, where possible, interprets congressional enactments so as to avoid serious constitutional questions." *Cheek v. United States*, ___ U.S. ___, ___, 111 S. Ct. 604, 611 (1991). The preemption analogies used by the court below, however, unnecessarily raise important Supremacy Clause issues. In cases involving the relationship between two federal agencies, as here, the Court has limited its analysis to the applicable statutes. *Pauley v. BethEnergy Mines*, Inc., __ U.S. __, __, 111 S.Ct. 2524, 2539 (1991) ("an interpretation that harmonizes an agency's regulation with their authorizing statute is presumptively reasonable ..."). The court of appeals' decision

to rely on an unnecessary preemption analysis, to the potential detriment of the States, and to interfere with a reasonable statutory interpretation by FERC, is error.[3]

The crux of the issue is that the SEC has neither the statutory authority nor the expertise to set wholesale or retail electric rates. The SEC's authority is intended to prevent collusion and abusive self-dealing between the affiliates of utility holding companies that could occur through their contractual relationships. *See*, 15 U.S.C. §§ 79a(c), 79m(b), and 79m(c). Potential abuses of the horizontal relationship between holding company affiliates are regulated by the SEC's imposition of a ceiling on transfer prices. By contrast, the FERC's role is to ensure reasonable rates to be charged by a

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[3] Even if preemption analogies were appropriate, the decision below is seriously flawed. As the Court stated in *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986), the authority of a federal agency such as the SEC to displace state regulatory jurisdiction must be firmly grounded in the agency's statutory authority:

> An agency may not confer upon itself [preemptive] power. To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress. This we are both unwilling and unable to do.
>
> 476 U.S. at 375.

utility subsidiary to its wholesale customers -- a vertical transaction. *Electrical District No. 1 v. FERC*, 776 F.2d 490 (D.C. Cir. 1985); *Towns of Alexandria, Minnesota v. FPC*, 555 F. 2d 1020 (D.C. Cir. 1977). In practice, the FERC reviews a utility subsidiary's management of the agreements whose establishment was approved by the SEC. The point here, however, is that it is the FERC, and not the SEC, that has ongoing jurisdiction over utility operations at wholesale under the FPA. *City of LaFayette, Louisiana v. SEC*, 454 F.2d 941 (D.C. Cir. 1971).

Equally important from the NARUC's perspective, the Court has often recognized that "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states." *Arkansas Electrical Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983). Accordingly, it has sought to protect the flexibility and discretion of State (and Federal) utility regulators in exercising their judgment. *See, e.g., Duquesne Light Co. v. Barasch*, 488 U.S. 299, 316 (1989); *Permian Basin Rate Cases*, 390 U.S. 747 (1968); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Thus, in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), this Court carefully limited

federal preemption of State public utility commission authority to cases resulting in "trapped" costs.

Nantahala and *Mississippi Power* make clear that "trapping" of costs can occur only where one governmental agency *requires* a utility to incur specific costs and a second agency sets a price that ignores the utility's obligation. *See Mississippi Power*, 487 U.S. at 354 ("it obviously cannot be unreasonable for [a utility] to procure the particular quantity of high-priced ... power that FERC has ordered it to pay for."). Thus, in *Nantahala*, the Court made clear that "a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher cost power is obtained at a FERC-approved, and therefore reasonable *price*." 476 U.S. at 972. Here, the Ohio Power Company was not *required* by either the SEC orders at issue or Section 13(b) to purchase high-cost coal -- or any coal at all -- from Southern Ohio Coal Company (SOCCO). Thus, neither *Nantahala* nor *Mississippi Power* can be fairly read to preclude State public utility commissions or the FERC from scrutinizing the reasonableness of those costs or similar captive costs and disallowing their pass-through if warranted.

By contrast, the decision of the court below would entirely oust both State commissions *and* the FERC from

jurisdiction over *all* captive coal costs, as well as the costs of other inter-affiliate transactions. What is worse, it commands this result in response to SEC action that provides no serious scrutiny of the reasonableness of the "costs" one affiliate charges the other. Moreover, by vesting exclusive jurisdiction over inter-affiliate transactions with the SEC, the decision below threatens to eviscerate the wholesale and retail ratepayer protection currently provided by FERC and State public utility commissions. As Judge Mikva recognized in his concurrence in *Ohio Power Co. v. FERC*, 880 F. 2d 1400, 1412 (D.C. Cir. 1989), "the SEC's approval of the various transactions was grounded on the financial aspects of the corporate arrangements, not on the reasonableness of the price paid for coal."[4]

Indeed, the SEC is incapable of rate regulation.[5]

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[4] The decision below directly conflicts with this Court's holding that "Congress. . .delegated to. . .the Federal Energy Regulatory Commission **exclusive** authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce, without regard to source of production." *New England Power Co. v. New Hampshire*, 455 U.S.331, 340 (1982).

[5] The SEC itself has repeatedly emphasized that it has "no power over the ... dealings [of electrical utilities regulated under PUHCA] with their customers, retail or wholesale." *American Electric Power Co.*, 46 S.E.C. 1299, 1323 (1978).

Unlike the FERC and State public utility commissions, the SEC has none of the technical expertise, authority or administrative apparatus necessary for effective rate regulation. The SEC even lacks the fundamental ratemaking power to suspend rates and order refunds. For this reason, there is absolutely no assurance, much less likelihood, that an SEC-approved cost would result in a rate that is just and reasonable.[6] Accordingly, the suggestion of the court of appeals that the ability of the FERC or, presumably, a State public utility commission, to "comment" on or to request an SEC investigation of proposed inter-affiliate transaction costs bridges the regulatory gap created by the decision below is completely fanciful. *See Ohio Power Co. v. FERC*, 954 F.2d 779, 786 (D.C. Cir. 1992). It also demeans the important functions of rate regulators.

The inevitable result of such gross lack of regulatory oversight is clear. Coal costs alone (not to mention the

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[6] The inadequacy of the SEC's "regulation" of captive coal costs in this case is evident in the court of appeals' inability to discern from the SEC orders at issue whether the SEC had established cost as both a ceiling and a floor for SOCCO's coal prices. *Ohio Power Co.*, 954 F. 2d at 785. Indeed, in issuing those orders, the SEC conducted no hearings and made no findings of fact whatsoever regarding any aspect, let alone the reasonableness, of the prices at which SOCCO would sell its coal to Ohio Power.

myriad additional costs that could and, most likely would, become the subject of inter-affiliate transactions under the decision below) comprise approximately 50 percent of the total cost of electrical generation. There can be no doubt that such costs, left only to "review" by the SEC under Section 13(b)'s "at cost" standard, would be inflated. The facts of this case show as much. In 1980 and 1981, just before the FERC adopted the "comparable market" cost test and initiated its investigation of Ohio Power's rates, the cost of coal purchased by Ohio Power from SOCCO was 50 percent and 94 percent over the comparable market price, respectively. Under the decision below, FERC and State public utility commissions will be powerless to prevent such abuses.

Similar opportunities for self-dealing, rate manipulation and rate-payer gouging by utilities subject to PUHCA abound.[7] In fact, the result of the court of appeals' decision will be to *encourage* utilities to adopt a holding company form

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[7] The potential for rate manipulation and abuse is particularly acute where a holding company-owned utility obtains SEC approval both to transfer assets previously included in its rate base to a newly created wholly-owned subsidiary and to purchase goods from that subsidiary "at cost" without further regulatory scrutiny. In this manner, a utility can simply spin-off inefficient or gold-plated operations and recover the inflated costs through SEC-insulated rates. Such disincentives to develop least-cost sources of fuel and other goods and services are intolerable.

to take advantage of such opportunities. Such a result is plainly inconsistent with Congress' express goal in enacting PUHCA of eventually eliminating public utility holding companies. 15 U.S.C. § 79a(c).

In sum, the court of appeals' decision in its entirety is fundamentally inconsistent with congressional intent and State statutory schemes. As Justice Stevens pointed out in *Arcadia I*, Congress clearly could not have intended to create the huge regulatory gap opened up by the court of appeals' decision which will enable utilities owned by holding companies to escape effective State and Federal regulation because of their corporate structure. *Arcadia I* at 423. To the contrary, in enacting PUHCA and the FPA, Congress intended utilities owned by holding companies to be regulated by both the SEC and FERC (*Id.*), as well as by State public utility commissions, to the greatest extent practical.[8] Sixty years after the passage of these acts, State public utility commissions should not be faced with the risk of preemption of a vital portion of their longstanding mandate to ensure the justness

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[8] *See* 15 U.S.C. § 79u ("Nothing in this chapter shall affect...the jurisdiction of any other commission, board, agency, or officer...of any State or political subdivision of any State, over any person, security, or contract, insofar as such jurisdiction does not conflict with any provision of this chapter or any rule, regulation, or order thereunder.")

and reasonableness of retail rates for electricity.

This Court in *Arcadia I* granted certiorari and closed the regulatory gap created by the decision below. In reinstating that gap, the court of appeals acted in direct conflict with this Court's decision and severely jeopardized effective Federal *and* State regulation of electrical utility rates. If anything, certiorari is more important now than it was three years ago. The NARUC respectfully urges this Court to review the decision below and remedy the broad jurisdictional consequences of its ruling.

CONCLUSION

For the foregoing reasons, the petitions for certiorari should be granted.

Respectfully submitted,

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